ENVIRONMENTAL LAW
A Case Study

Panel Discussion including Questions and Answers

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CASE STUDY

Nifty Nugget Casino Limited has recently won Government approval to build a large tourist development in Melbourne, incorporating the world's largest casino, the world's largest hotel and the world's largest indoor waterslide. Despite concerns as to the financial viability of the hotel and casino, Nifty Nugget is determined to forge ahead with the project. The development is to take place at a site on the north bank of the Yarra River, just upstream from a small island which is home to several unusual species of birdlife.

The site has been vacant since July 1922, when Nifty Nugget purchased it for $7,000,000 from Dodgy Drivers Pty Ltd. Dodgy Drivers was a road freight company which went into liquidation soon after selling the site to Nifty Nugget. The proceeds of the sale were used to pay debts to the Australian Taxation Office and various creditors. Soon after the winding up of Dodgy Drivers, the three directors of the company simultaneously developed chronic respiratory ailments and fled to a sanatorium in Outer Mongolia.

Until July 1922, Dodgy Drivers had used the site for 20 years as a transport depot for its fleet of trucks. Trucks were repaired on the site, truck tanks and trays were cleaned there and several hazardous chemicals were stored in a dilapidated shed. There are rumours that some minor spills of hazardous materials occurred in the 1970s, but details are sparse. The company also held licences at various times to discharge wastes from the cleaning processes into local sewers.

A highrise residential development is being constructed adjacent to the site, and excavation workers have noticed that some of the soil being unearthed is an unusual colour. Adjacent to the site on the opposite side to the residential development is a large tourist-oriented shopping centre. One of the centre's riverside food outlets, Melanie's Muffins, also earns

extra money by hiring out paddle boats on the river. Occasionally the boats capsize and Melanie has to don her pink swimming fins to rescue clients from the water.

Nifty Nugget has approached the Big Bucks Bank to seek finance for the casino, hotel and waterslide project. It desires a $200,000,000 loan, secured by a mortgage over the site and Nifty's other major asset, a casino and freehold on Norfolk Island. The value of the total security offered is acceptable to the Bank.

Big Bucks Bank is keen to become involved in such a high-profile development. In evaluating the project, as part of its credit risk assessment process, an investigation of the environmental condition of the site and surrounding area is required as part of the loan approval process. Chris Bishop, the legal advisor to Big Bucks Bank, also wants many warranties and indemnities in the loan document and an environmental assessment of the site! Nifty Nugget's lawyer, Chris Schulz, has been asked to give the Bank "nothing" but get the loan documents settled quickly. Schulz suggests that it may be useful to involve an engineering company, and recommends Dr Bryan Jenkins. Nifty Nugget is concerned that the cost of doing so, combined with legal costs, will cripple him and will also delay proceedings too much.

Schulz suggests a meeting between the three people to explore the risks involved — how they can be minimised and what reallocation of risk can be achieved.

The laws of Victoria govern this transaction.

TRANSCRIPT

The following transcript relates to the above case study. Questions raised and responses from the speakers appear throughout the body of the transcript.

Chris Schulz

What I hope we achieve in the course of this case study this afternoon is that we have a look, from a number of different aspects, at the practical side of being a financier involved with a contaminated site. For the purpose of the case study we are going to use the Victorian law, for a couple of reasons. Recent changes are due to come into effect in about the next fortnight in Victoria. They really do mark a step forward in relation to lender liability. We will cover that in more detail in a moment.

I thought what I would do initially, for the benefit of international and interstate people and for those of you who may not have looked at the Victorian provisions recently, is provide an outline of how they operate at the moment, and we can then use that to explore the case study.

The essential position under the *Environment Protection Act* in Victoria is that the Environment Protection Authority has the ability to serve a clean-up notice on either the occupier or the polluter of a given site and they also have the ability to clean up the site themselves. The Act provides that an occupier is deemed to be liable for the contamination of the site and therefore has an obligation to clean it up, whether that occupier is the polluter or not. A statutory ability is given to the occupier to recover any clean-up costs that that occupier might incur from the polluter. The occupier can spend his money on cleaning up the site, mount what will be a Supreme Court action against the polluter, and then, having established to the court's satisfaction that the polluter did in fact cause the pollution, recover the reasonable costs of decontamination.

In that framework, I think it is important to look from a practical point of view at how the EPA administer that law and how active they are. Essentially sites fall into a very broad category. The first is those that have off-site effects, so that the pollution is causing some off-site effect. The second is pollution that is causing only effects on the site of the particular lender or operation, but whilst they only have an effect on that site, they do nevertheless have some

effect on employees who are working on that site. The third category is where there is contamination on the land; it has no off-site effects, and it also does not affect the employees in any way.

Taking the first of those categories, where there are off-site effects, that obviously is where the EPA will be active and, in a sense, from a banker's point of view, that is the first thing you have to determine. Does the piece of land you are dealing with have any off-site effects? If the answer is yes, then they need to be attended to immediately.

The second issue — there are no off-site effects, but there is an effect on the employees — that is again something where you can expect some interference from the EPA, and something that you have to pay attention to.

The final area then is where there are no off-site effects and no effect on employees. That is nevertheless something that, from the point of view of the company occupying that site, is a contamination that needs to be addressed over a period of time, so that the site can be cleaned up. From a banker's point of view, they would need to be satisfied that some programme is in place to clean up that pollution, so that either when the site is to be sold or to be used for further security, there can be some certainty as to what the condition of that site is.

Again from the point of view of this definition of "occupier" — and we will hear a bit more about that from Chris Bishop in a moment as to how that is going to change in about a fortnight's time — I do not think that there is any doubt that a banker can be deemed to be an occupier of a site. The definition talks in terms of occupation or control of a property. So I think in that context there is no doubt that a banker can be an occupier and is therefore exposed to the clean-up costs for that site.

One provision that also needs to be looked at fairly carefully is the charge on the property. At the moment the Victorian Act is worded in terms of if the occupier cannot be found, the clean-up costs can become a charge on the property. This is a fairly curious provision. That is going to be changed in a fortnight's time to read that if the clean-up costs cannot be recovered from the occupier, then the clean-up costs become a charge on, not only the land in relation to which the clean-up costs were incurred, but also on any other property of the occupier. So you have a potentially broad range of assets that may be the subject of this charge. So long as the provisions in the Act are followed, that charge ranks ahead of secured lenders.

The ANZACC proposal, that is the Australia and New Zealand and Conservation Council, which is a group of the Environment Ministers of the Australian States, the Federal Government and New Zealand, provides for financial liability for contaminated sites, which is intended to be the basis of legislation. Obviously so far as the Victorian context is concerned, that has limited relevance because the legislation is already in place and does not necessarily correlate with what the recommendation is.

I think the Victorian example is much better than the ANZACC proposal. Chris Bishop also will give a bit of background on how this is not really what the Bankers' Association had in mind at all for the Ministers to adopt.

That really takes me to the final point that I want to make. The purpose of the case study is to come up with the practical steps that I think should be part of the assessment of whether this particular property is going to be suitable security for the sum advanced and how you ensure that you have all the information available to you before the first draw-down. Any further information that you need to assemble in the way of audits during the currency of the loan should be obtained. Then consider the steps that you need to take before you make a decision to enforce your security.

The final point that I make is in relation to the certificate statements of environmental audit. At the moment, the certificate of environmental audit is provided for under the *Environment Protection Act*. This is not being used very much at all, because the auditor under such a

certificate is required to state that the land is capable of being used for any use. He is unable to limit that certificate, and therefore in circumstances where there is some residual contamination, he is unable to issue a certificate under the Act. The statement is again part of the amendments to the *Environment Protection Act* that are going to come in, in the next couple of weeks. And that, in a sense, enables the auditor to give a qualified statement, so that the statement can say: "I think the property is capable of being used for industrial purposes" and go into some detail about that "but it is not capable of being used in its current condition for residential or such". So I think that the statement of environmental audit is going to become a very important part of the assessment of any loan, where you do have a site that is contaminated.

[Slides used by Chris Schulz in his presentation are reproduced at the end of the transcript as Attachment 1.]

Chris Bishop

In the short time we have today, what I am going to try and do is outline the background of the Australian Bankers' Association's ("ABA") approach on behalf of the banking industry to this issue of lender liability for contaminated sites.

This morning we heard about guarantors whom I ubiquitously described as "fools with a pen". When you are dealing with contaminated sites, and it has become a flavour-of-the-month word for bankers particularly in retail lending, I think you are very close to a bank being a "fool with a cheque book". The difficulty you have is in balancing that dreadful position of future risk — at the moment legally it is unquantifiable risk due to the direct liability potential of a bank in respect of contaminated sites — against the margin that you pull in relation to a loan.

The ABA set up a task force in 1990 (it seemed like a tricentennial exercise four years ago) to try to persuade government that the banks' business of lending involves a margin spread, not the collection of the money associated with its security, and putting at risk not only the principal of the loan that was made due to insolvency and incapacity to repay, but also lumbering the banks with direct liability for contaminated site remediation into the millions of dollars in respect of any small loan, was just plain madness.

Regretfully, the legislative regime around Australia is exactly that, except Victoria, which I will go through in a bit of detail. The position of occupier and owner by legal mechanisms encapsulating the banks as being in the liability net was originally said to us, when we first met with Ministers in 1990, to be exactly what was intended by the legislation.

It has taken a very long time to persuade Ministers. Members of the ABA task force and Alan Cullen its executive director, have spoken on a number of occasions to each Environmental Minister around Australia. Each of the Environmental Ministers has given written commitments that it is not the political intention to make a bank liable for contaminated site remediation in the financial sense. Regretfully, Victoria is the only shining light on the horizon that has taken that political promise to heart and done something about it.

Chris Schulz mentioned the ANZACC process and this has been a process which the banks got into at an early stage with a view to naively believing that national uniformity in the template style of laws like the proposed credit legislation or the old company laws would be the panacea for certainty across all jurisdictions. Did we get a shock when the final paper of ANZACC came out with those principles of lender liability that are espoused, particularly that of which requires the lender to elect whether to take on the full liability or abandon the site. I think in the future if this policy of the Ministers permeates into legislation in the other States, you will end up with land banks and orphan sites of an incredible proportion, which will send us down the road to the US Superfund style operation.

A submission handed to every Minister and the Director of the EPA on the evening of the ANZACC meeting suggested that the draft report should be changed. The essence of that

change was to request that lenders should not be discouraged from entering into possession of their security and restructuring the assets of their insolvent customers. The very fact of what is proposed by the ANZACC process does lead to that situation. We submitted that a legislative framework needs to be established in each jurisdiction to provide lenders certainty, and that is the confidence factor that has been eroding deals being done over the last four years in this area. We wanted certainty for the member banks to be able to go forward and practically lend against risks that they can quantify. We wanted the Ministers to recognise that lenders should be allowed to use every means available within the market to achieve a restructuring in an insolvency situation while complying with good environmental practice.

It was accepted up front from the banks that the focus of environmental issues has changed dramatically. Each of the banks' lending processes now do deal with environmental matters and we said that the desirable position would be to have a framework where environmental risk was just part of the credit risk assessment process and not a risk which absolutely and totally dominates the process.

From my perspective in retail lending, when the issue of environment first started to surface in the late 1980s and early 1990s, it was not so much the new deals that really were the problem, it was the ones that were on the books at the moment. And for new deals, many bank managers were saying "you mentioned the word 'contaminated' site and it was equivalent to cardiac arrest, and there would be no further negotiations in relation to the provision of a loan". Regretfully, that position still is somewhat applicable.

What the ABA suggested was a four-tier approach to set out in that material, that parties with a security interest in land should or indeed must be able to be made readily aware of contamination (and that is not currently the case with the state of the registers) and also be able to be aware of any action of an environmental regulator which would affect the security interests.

We agreed that lenders in possession of a property should be obliged to maintain the property as a non-risk site using the ANZACC label — in other words, the site does not pose a threat to the environment or off-site contamination. But a lender should take on the responsibility of mitigating threats to human health and risk to the environment in relation to a possession situation.

The very important thing that could cause a lack of confidence in Australia was the experience of the US with the Superfund and *Fleet Factors* case. We stress that lenders should have their liability for past contamination limited to the loss of the loan principal outstanding without direct liability for remediation. That, in my view, encapsulates the position of the banking industry. Lenders should have their liability for past contamination limited to the loss of the loan principal. We think it is a reasonable given, but it has not been the response of the regulators.

There is light on the horizon — it is called Mark Birrell of the Victorian Liberal Party. He took a very practical approach to the fact that there did need to be amendments to the Victorian Act to reflect the political commitments that had been given and to stimulate the so-called economically or environmentally sustainable development in Victoria and particularly in the area of major projects. So the political process of negotiating with the Opposition (although that was hardly necessary because of the numbers) a lender liability exemption format which would be workable, and would meet the balance of protecting the environment and restoring lending confidence.

The problem we had with this proposal was that it had been around for some time and there was an amendment Bill going through, and the criteria allowed by the Minister in Cabinet was that it was to be an amending Bill and not a Bill separately dealing with contaminated sites. So in essence, when you read the provisions, you will see they are pretty much a potpourri of concepts that were thrown together late one night in fact, to achieve the amendments. They are not utopian from a legal sense, but the banking industry believes they at least represent a very good start. Ironically, the biggest section in the amendments is the definition of

"financial institution". At the last minute the government was moved to bring in finance companies which were inadvertently left out of the exclusion from the outset.

Good lobbying by our colleagues at the AFC secured that ubiquitous amendment, (which is a style of legislative drafting that annoys me). Under paragraph (d) which is in the notes, the exemption extends, or the definition of "occupier" is modified, if it is a financial institution being a financial corporation within the meaning of section 8 of the *Financial Corporations Act* 1974 of the Commonwealth which is registered under category D, E, F or G of the Act. Typically you go straight to the Act and cannot find any details on it, and you have to hunt through the *Government Gazette* (in fact the *Government Gazette* of 4 December 1990) that lists the categories of financial corporations in the definition within that sub-section.

Essentially, it was designed to limit — and this is very important from a government's perspective — the financial or lender liability exemption in the Victorian Act to genuine arm's length financiers, to avoid the situation where you could have a position where company A established a financial subsidiary (company B) close to the land in the name of company B, the $2 company which provided loan funds to the real operator, and then sought to gain the benefit of the exemption of the financier by virtue of fitting within the definition.

The Queensland Government are also very concerned to limit the application of the exemption to genuine banks, credit unions, building societies, friendly societies interestingly enough, and all full-range finance companies.

The legal mechanism that was used within the amendment provision was to take the banks out of the net of being an occupier. It was done in a clumsy way, but the principle was relatively clear. The definition of an "occupier" in the Victorian Act is not intended to include a person being a financial institution as defined, and acting solely as the holder of a security interest in the premises or as the mortgagee in possession which is or appoints a controller of the premises. A pretty mixed bag of people are excluded from the definition of occupier for general passive lending situations.

You might note that despite intensive lobbying by the ABA and others, the government steadfastly refused to include a receiver or manager in the direct net of the exemption. The exemption falls upon the financial institution and not, in my view, the controller or receiver and manager in their own right. I think that will lead to a new regime of indemnities to receivers and managers where they will be authorised to do acts that fall within the exemption of the financiers under the Victorian model rather than the general indemnity to do everything as receivers are oft to require. But it is an interesting situation. It is meant to encapsulate the US EPA approach that it is a passive lender; simply holding security, or simply acting as a mortgagee in possession does not attract liability in itself. So you can use the resources of your security document, formally take possession, change the locks, and provided you do nothing, (which is quite often what many of the banks do in this area), you can hold it on portfolio and will not be directly liable for past pollution.

That is the good news! The bad news is that as a trade-off, in a political sense, the government was only prepared to give an exemption for passive lenders and lenders enforcing security interests. The trade-off as indicated in the ABA's principles was that a lender would still be liable for, or would be deemed an occupier for the purposes of sections 31A, 31B and 62A — the notice or enforcement provisions of the EPA — but be deemed an occupier for the purposes only of abatement of any environmental hazard. Now that is a term that is used in the EPA and it was meant to differentiate for clean-up, full/total clean-up, preventing off-site contamination and avoiding a risk occurring to health or the environment. So you are in the net and the liability net absolutely if you take possession and you are then obliged to remediate in a sense — we call it the stabilisation factor or contain the contamination that you find there.

However, consistent with the government's principle of applying the normal rules — the polluter pays — which was meant to be the underpinning basis for the ANZACC paper, the exemption or limitation on the liability is taken away. Lawyers will have a field-day to determine what these clauses mean. It is taken away when a bank or a lender is a mortgagee

in possession or appoints a controller and it has possession and day-to-day active management and control of the premises. They are terms that jump up to lawyers. You will be liable for ongoing management and control, and you have got those legal principles of control and management. Day-to-day active management was creatively included to try and draw a line in the sand for simple monitoring as opposed to actually running the business. The principle that is important is enshrined, attempted in that definition, is that one is not liable, one is not an occupier for pollution that occurred prior to the financial institution becoming a mortgagee in possession or becoming or appointing a controller. Those words, in my view, will practically lead to the revitalisation of the Environmental Auditors' Association and the engineers' assessments. A bank will have to determine, when it is thinking of going into possession, what past contamination is present to bring itself within the umbrella of the exemption. Banks will have to draw the line in the sand and essentially that will, in my view, lead to a greater use of environmental assessments (I do not like to call them audits), but they will probably become full-blown audits in due course. But a bank will probably not move to any major financing facility involving an environmentally sensitive industry, without the benefit of a full environmental assessment and probably under the Victorian model, a statement of audit as opposed to a certificate of audit.

[Chris Bishop provided a prepared commentary and other hand-out materials which included the Explanatory Memorandum to the *Environment Protection (General Amendment) Bill*, the Table of Provisions to this Bill, extracted sections of the Bill and the *Environment Protection (General Amendment) Act 1994* relevant to the discussion, and a document entitled "Environmental Loan Documentation Clauses". These materials are reproduced at the end of the Transcript as Attachments 2A to 2F.]

Dr Bryan Jenkins

What I would like to cover in the introductory remarks is firstly look at the liability of lenders, and then some of the issues that relate to site contamination.

As Chris Bishop mentioned to you, if you look at the liability for lenders under the Victorian *Environment Protection Act*, and Victoria is probably the first State to try and clarify the situation of what lenders' liability will be, and compare it to other States, you notice it is about as consistent as our railway gauges were about a hundred years ago.

The first concept is one of passive lender, and that is where the lender of the money is not involved in site management and the legislation makes that person not liable for pollution clean-up costs or offences. If you become the mortgagee in possession, you do have a responsibility to make the site safe and that is to abate any existing hazard. So how do you, as a bank, know whether it is safe or not?

Even though you are given a clean bill of health in terms of the liability for past contamination, if the operation is not within the law when you take it over, you then become responsible if that operation is operating outside of the pollution Acts.

Financial institutions should be looking at the environmental liabilities in their loan assessment. Just to give you one example: we were dealing with a takeover situation where a company had been using transformers, they had PCBs — PCBs are toxic, you are no longer allowed to use PCBs — they had cleaned them out of their transformers. What they had not done was check for contamination of the site with PCBs. So when we did a site contamination assessment, we found that their equipment was clean, but their site was not.

The next component is to encourage environmental management by your debtors. One of the major defences that is now available for people who will be receiving the money from you is the issue of due diligence, and they will have to be able to demonstrate in a court system that they have an environmental management system, that they undertake audits, so it is not necessarily the banks that will be doing that work, but you should be ensuring that the people who are receiving the loans have those environmental management systems in place.

When you are in possession, then you have to ensure that the environment is protected. If you look at the financial institutions in terms of their environmental responsibilities, they need to manage the hazards they inherit, they have full responsibility for the businesses that they manage just like any other manager, they are not liable for past pollution, but there is still the catch there if the land is devalued. If you look at what is happening in most of the site contamination and site remediation work that is going on in Australia, I do not know of any site in Australia where the added land value of site decontamination can actually match the cost of remediation.

To give you one example: Oyster Cove, harbour frontage land in Sydney, an old gasworks site. They have only gone for a containment solution, not a remediation solution. And even that land, going from industrial to residential, cannot stand the cost of remediation.

In urban areas the major concerns are contamination of groundwater and the acceptability of the land use, particularly when you are converting industrial land to residential land. The key problem areas that I have mentioned, the residential development on contaminated land, just about every State has its classic example. There is Ardeer in Victoria where residential development occurred on an old scrap metal works; there is Kingston in Brisbane where there was land development over an old tip and there was leaching of heavy metals and toxic materials into the residential environment. It can also occur with abandoned industrial land where there is past contamination but no-one available to clean it up, and with waste disposal sites. There is a lot of land area now, for example the Multi Function Polis site at Gillman which is really Adelaide's old waste dump, which people are now converting into a new-age city. There is certainly going to be a lot of interesting site decontamination work required there, similar to the Homebush Bay site in Sydney which is again really an old rubbish dump they are now converting into an Olympic Games site.

It is not just the urban areas that you need to be concerned about, it is rural areas as well. There can be contamination of agricultural produce, and this was certainly a major concern with pesticide residues with meat being sold to Japan, and also with contaminated run-off. The major cause of algal blooms in the Peel Harvey Estuary in Western Australia is due to fertiliser use in the upper reaches of that catchment. And they are really the two key problems — the pesticide use and the fertiliser use — in terms of contamination in rural areas.

There are two regulatory approaches that have been debated within Australia. The first is having adherence to a predetermined soil criteria. This is used to define a condition of contamination, that if you exceed a particular level of say arsenic in the soil, then you have a contaminated site. It also serves as a standard for clean-up. There is some reluctance to adopt that approach in Australia consistent with what has happened in Europe. Three-quarters of the residential areas in Brisbane would be classified as contaminated sites if we applied certain European criteria.

We are now looking at a slightly different approach, which is really the recognition of the environmental consequences. The soil criteria is used as a guidance to investigation requirements. So if you meet the soil criteria, you do not have to go any further. If you do not meet them, then you have to do further analysis. You try and develop site-specific criteria, and this requires exposure and risk assessment.

If you look at some of the exposure pathways that have to be considered, and there is certainly a wide range of those — whether it be inhalation, whether it be skin contact, ingestion — you find that for residential development probably the dominant pathway from all of the analyses that we have undertaken is how much dirt a three year old child will eat! And it is not just in terms of residential development. A lot can occur on construction sites, not necessarily in relation to activities directly related to that site. When we were looking at construction on Sydney Airport, the biggest problem there in terms of site contamination was leakage coming from the sluice drain which is a major Sydney outfall sewer going through the site, and there had to be special precautions taken not just for the land use, but during construction for protection of the workers.

If you look at the major steps that occur in a site contamination audit, the first is the identification of possible contamination. This really requires a preliminary investigation to find out with the past land use, with the operations on the site, whether there is the potential for site contamination. There is then a need, if there is deemed the possibility of contamination, for a systematic sampling and analysis programme.

One of the hardest things with soil contamination if you are going to prove that the entire site is clean, you actually have to analyse every grain of soil for every possible known chemical, and clearly this is not practical.

I have mentioned the issue of health and environmental risk assessment, and then finally, if you are going to do anything with the site, you need to be able to develop a remediation strategy.

If you look at the sorts of strategies that are being considered, the typical response in the past was removal of the contaminated material and disposal in land fill. This was certainly the approach that was used in Britain for quite some time, but after they had moved the same contaminated soil three times over a period of about fifty years, they decided that there may need to be alternative ways of achieving long-term remediation.

The preferred approaches that are now considered in Australia are treatment in situ, which is usually quite expensive. If you take the Maralinga case at the moment, they are trying to contain the plutonium by in situ vitrification, which is effectively turning the soil that contains plutonium into glass by putting in two large electrodes and melting the soil — so you can see that is not necessarily a cheap way of solving the problems.

You can also get treatment of the excavated soil. One example we used in a land development in Adelaide where there was an old rifle range, rather than go into any form of chemical approach we actually used a mining technique — dug up the soil, ran it through a mineral separator and got out the copper, brass and lead, and used that to offset the cost of remediation. And that was quite a cost-effective way of doing it.

But what we find is that the most common approach is isolation by encapsulation or barriers, and that is putting a clay layer over the surface, possibly putting in clay walls to prevent movement into ground water, and there is a whole range of options that have been considered there, which is generally the cheaper way of doing it. What we are also finding is that if either treatment or containment is not possible, and that usually means in economic terms, then you are getting restrictions on future site use. And we are starting to find, particularly in the Sydney and Melbourne area, that there are a large number now of abandoned industrial sites where it is not cost-effective to turn them into residential, they are not suitable for industrial, and they become abandoned sites.

The final thing I want to mention is in addition to the site contamination assessment work, if you become the person responsible for the operation of the site, it is worth looking at a range of preventative measures that you may wish to require either the operator or your own organisation to undertake. For example, in terms of the site selection, you need to consider the vulnerability of the environment to contamination. This is particularly a problem in Perth where you have underlying groundwater which is used as a viable resource and one needs to look at how you protect the groundwater resource there because again that can become a criminal pollution offence if it continues. If you look at the issue of process design, there are certainly a lot of old industries where the processes that are used are environmentally unfriendly. For example, the issue of chlorine bleaching that has been used for pulp mills, we are now starting to see people move away in terms of the process design to alternative technologies, in this case peroxide steep bleaching, so that you do not produce the organo-chlorides that are the major concern with pulp mills. There is also a need to incorporate pollution control equipment. There is increasing stringency in the standards. You may find that the site that you inherit cannot meet the pollution control requirements and you may have to look at upgrading the pollution control equipment.

It is also important to look at the range of equipment features on the site, whether there are leak detection systems in place, particularly for underground storage tanks (25 per cent of underground storage tanks that are about ten years old are guaranteed to leak), whether there are the appropriate enclosures and secondary containment, that you actually have bunding around the site so that if there is a spill it can be contained, issues of corrosion reduction, putting in above-ground storage rather than underground storage, and the use of low leakage pumps and valves. Also looking at the whole issue of the housekeeping of the site, that there is immediate clean-up of spills that is put in place, that the maintenance of the drainage systems is maintained so that you are actually getting rid of a lot of the waste material the way it was intended. If there are high risk areas, these have to be separated. You must undertake material and waste audits to make certain that you are meeting the range of environmental requirements. An area that is particularly the case in South Australia and Victoria, the need to document and account for any waste that is removed off-site, having a manifest system, they call it, in place, so that you have indicated how that material has been disposed of. Ensure that the protection systems that are meant to be there are inspected and in place. And quite often what is important is that the staff who are actually operating the plant, and if you are taking over a new plant, are actually trained in how to operate the environmental systems and protection systems that exist on that particular site.

[Slides used by Bryan Jenkins in his presentation are reproduced at the end of the transcript as Attachment 3.]

Professor Robert Baxt, Chairman

I will ask Chris Schulz to now take us through the case study with Chris and Bryan, and I think that you will tell the audience how you want them to come in and attack you or ask questions etc.

Chris Schulz

You have all got the case study in front of you, so I will not read through it. What we thought we would do is just look at a couple of issues that we would each look at in the roles that we have been assigned in the case study, and really it is very much each of us giving you the information you want. Probably the place that I would start in the position of Nifty Nugget's lawyer, knowing that the site has had a fairly chequered history, would be to retain someone like Bryan in order to give me some advice on the condition of the property. The sort of thing that I would take into account there is the issue of legal professional privilege in relation to the reports. I think that is a bit of a red herring in Victoria. The EPA said there on many occasions that privately obtained audit reports are not going to be used by the EPA in any prosecutions, but nevertheless I think the tendency has been for it to be cloaked in that way of me asking Bryan to provide me with a report so that I can give Nifty some legal advice on what his obligation is in relation to that site, and I might ask that question of Bryan in the sense of having been retained as the environmental auditor for the purposes of this site. What would you do? How long would it take? And more importantly, how much is it going to cost?

Chris Bishop

Chris, can I interrupt there because I just want to clarify something, You are paying Bryan's bill, is that correct?

Chris Schulz

I might. It depends on how much it is.

Bryan Jenkins

Well the first thing I would ask for Chris then is a contract from you to actually undertake the work.

Chris Schulz

Which then leads to the scope of the works please.

Bryan Jenkins

If you look at the approach that we would normally recommend for looking at a site, there is really a series of steps that need to be undertaken. The first is what I would call a preliminary analysis, and this is where you are looking at the site history. Is there the sort of chemical that are of concern being used on the site, either in the current operations or in past operations. If you take the case of Port Pirie where there are some major problems with lead contamination, it is not coming from the world's largest lead smelter that is operating now, it is from those operations that occurred 50 or 100 years ago when there were less concerns with pollution control. The action there is to go through the site history, the site description and possibly some preliminary sampling, and with comparison with the soil guidelines to make a decision. And if there is no problem apparent, then you need to take no further action. So the first step is the preliminary analysis to determine whether you have really got a problem or not.

If you identify that there is a potential problem, there is then a need to go to the next stage of a site investigation — to develop a sampling and analysis programme and then to determine the extent of contamination. Where areas are found that there is no contamination, no further action is required.

Where the answer is no, there is a need for additional investigation and you go through that cycle again. And what is quite common is to have a stage approach to site sampling. You do not want to cover the entire site with dozens of holes if you do not know that there is a problem. One of the common examples is with underground storage tanks. You have a 25 per cent chance with most of the storage tanks that there is a potential problem. Put in the first sample bore, if you find that there is no contamination of fuel, then you need to go no further. If you find that there is contamination, then you start leap-frogging out from that particular storage vessel to see how far that contamination may go.

If you find that there is a clear definition of the extent of contamination, the next step is then to go to assess the health and environmental effects. If there are no unacceptable impacts, there is need for no further action. And that can sometimes happen. In the case in Victoria where there was arsenic contamination found on a residential site, in levels that were at least ten times what are considered the safe levels, people then looked at what the environmental pathways were for this arsenic to actually get out into the environment. It was found to be tightly bound in clay, the chances of that material being released to the environment would only be increased if you removed it, you were much better off leaving that arsenic contaminated soil at the site. So even though you had found contamination that was unacceptable in terms of the soil criteria, no further action was taken in that particular case because there were no unacceptable impacts.

If there are unacceptable impacts, then there is a need to develop the site remediation plan, to implement the remediation plan and then to monitor against the clean-up criteria. And one of the things we are finding is that even though there is a range of techniques available for clean-up, the likelihood that they will be as successful as people anticipate, is doubtful. This has been particularly the case with a lot of bio remediations where people are using bugs to clean-up, they are not necessarily getting down to the clean-up levels that are considered acceptable. If you find the criteria met, there is need for no further action. If they are not met, then you need to come up with a revised remediation plan.

If you look at that as the broad potential scope of work, you can see that putting a cost on all of that is quite difficult. The first task, which is usually the preliminary assessment, can be a relatively minor cost, depending on the size of the site, between $5,000 to $50,0000 depending upon the number of hectares involved. When you start getting into the sampling and analysis that has to be undertaken, that is when it has to be site specific. If you look at the costs associated with Homebush Bay, a rough figure for the amount of analysis work that has been undertaken there, just in terms of the chemical analysis work, is the order of a million dollars. So you are talking about large sums of money for large complex sites where you have substantial contamination. And if you are looking at the cost when it comes to developing site remediation plans, the Bayside development in Victoria — the development on the old BP site just south of the city — that was a $20 million cost to effectively wash the top one metre of the entire site, to excavate the soil, to wash it and then to replace it. So you can be talking about quite substantial sums of money when it comes to site remediation.

Chris Bishop

Perhaps I could come in there from bank's perspective and indicate what the first call would be in relation to this case study. Two things concern me looking at Bryan's diagram. The important thing in this case study is that the bank is going to have to make a judgment call of the value of the security and how important it is to them, because in the event that they are going to have to go into possession you have got a serious concern, in my view, that you are dealing with what was an industrial site and you have got a construction project proposed which is going to lift the use to a residential use.

So inevitably in the planning process in Victoria, as I understand it, there would be alarm bells ringing very carefully in relation to the history of this particular site, and you may not be comfortable with stage 1 or phase 1 of a preliminary assessment. Certainly that would have to be done and I would postulate for the future that I think those types of assessments are going to become commonplace in a bigger ticket project financing and even in the middle market scenarios, due to the need of a bank to draw that line in the sand that I was talking about, to ascertain what past contamination was.

The facts are somewhat emotive in the material that is given, and it would lead any credit analyst, one would hope, who has now focused on the issue of environmental risk, that there are a number of potential dangers there and you would have to endeavour to quantify those processes. The way we would attempt this, I believe, would be to ask Nifty's lawyer to provide a site assessment and an environmental assessor's or auditor's report. The interesting part about that is who pays? Naturally our precept if it was not known that we were anxious to do the loan, certainly I would be saying to Chris, "you want the money, you do what we ask". And in fact that is commonplace in the lower end of the market. We would need an assessment before you even get this issue off the ground.

Practically, my concern in the real world is understanding an environmental auditor's report and getting a report that can give the level of comfort to a bank in the relevant time frame that you are generally looking at to give the loan approval. So essentially you probably have a conditional loan approval which would be subject to a whole raft of conditions and warranties etc that are set out in the documentation that has been distributed as a first stage. But without doubt, in view of the history of the site and the anecdotal evidence that is shown, a very detailed analysis, I would think, would be necessary in this case.

Chris Schulz

I think the important point there if you are in the position of the borrower's advisers is the timing of all of this. In a sense, as Nifty's lawyer, you would need to be talking to him about directors' personal liability and telling him about the due diligence defence under the Act, and in a sense the sort of study that Bryan is talking about would be a very important part of getting that defence up. You would not have a hope if you did not have all the facts assembled, and to that extent, whether Nifty was funding this himself or getting money from

a bank, you really should be advising him that you have just got to know what is going on with that site in order to ensure that there are no off-site effects. From a timing point of view, obviously what Bryan has said can, in relation to a site that is a fairly contaminated industrial site, be a very time-consuming process. My experience is that soil tests have completely different time constraints to the other audits that you may come across. There are audits in relation to air emissions, there are audits in relation to legal compliance. All of those things, if you are pushed, you can do in a very short space of time. But these sorts of soil investigations at best take a month or two, or more, and in a very complicated site can take a much longer period of time.

Question - Peter Willis (Mallesons Stephen Jaques, Melbourne)

What sorts of risks are you actually talking about. I mean some oil spills? Perhaps Bryan can tell us who is at risk. You are saying there is a hotel there. Are we going to die of it, or what?

Response - Bryan Jenkins

If you look at the sorts of concerns that come about where you go to residential development, there is the problem of genuine health risk, that if you have toxic chemicals there is the potential for ingestion of those toxic chemicals, and that is probably one of the major concerns with residential developments. If you take the example of Kingston, there was actually toxic material leaching up into the surface part of the soils where people can be genuinely exposed, and that is in the actual use of the land. One of the other major concerns is when you go into construction, because that is when you are actually getting people who are digging into the soil and the protection that might be required for construction workers can be quite high depending upon the degree of contamination. The lengths we had to go to on Sydney Airport to protect people, in this case it was a health risk from sewerage bugs, was quite high. They all had to be suited up and required respiratory protection as well. So you have got those health risks that are probably the major concern.

There is also the potential concern in terms of ecological risk, although that has not seemed to be a major issue in most of the sites in Australia. But it can cause problems. The discharge of contaminants into any water body is probably a criminal offence, so if you are the owner of the site you would be subject to criminal penalties if you are actually discharging, through the groundwater system, pollutants that are above the limits. There is no site contamination legislation in South Australia, but there is the *Water Resources Act* and if you are contaminating under the *Water Resources Act*, you are then guilty of an offence.

So there is the health risk and then there is the pollution risk which you have to be concerned with.

Question - Ian Samuel (Smith & Emmerton, Melbourne)

Can some of the questions on the site that you are talking about or any of those sites particularly in Victoria in South Melbourne, be dealt with by insurance? You are dealing with areas where you know that there is a possibility of a risk, your senior pile driver is down having done soil tests etc beforehand, but I as a bank am still a bit wary about the whole thing Chris, and need protection to ensure that on a cost complete basis that the bank will not be left with a $20 million clean-up as you had down at Bayside.

Response - Chris Bishop

Perhaps I can respond to that. The sample (and they were only sample covenants in the materials that were attached to the case study) indicated in one of the covenants (B(1)) that the borrower should covenant to maintain adequate insurance to the satisfaction of the bank both for the assets and if necessary environmental impairment liability insurance cover. In my experience to date, insurance is said to be the panacea, but it has never emerged. In fact

I do not think this is an insurable risk and you would not get insurance at all on this specific issue. That clause, as I am sure Chris as Nifty's lawyer would say, "you are in cloud cuckoo land to want that particular clause for this site specific project".

Response - Chris Schulz

The various insurance products that have been touted or have been prepared in a draft that I have seen have all had as a prerequisite, transferring all of your wealth to Bryan Jenkins in return for the most amazing environment audit that you have ever seen, and until we have seen that audit we are not going to tell you what the premium is. It just got to a stage where the risk is one that the insurer, like everyone else, is very hesitant about, and the precondition for some sort of policy which has a meaningful effect is just such an audit. It would quickly recognise that that just was not going to be feasible and from that point of view, from an environment impairment point of view, about the only way you may get such a product is if you started a green field site which everyone can demonstrate is totally clean and then you run an organisation. Or take a chemical operation, for example, if you run that along the most strict environment standards with audits (and that on a regular basis), in a sense if you can demonstrate that you do not need the insurance, then you may well get it.

Response - Chris Bishop

I think it becomes an issue of site specific again. One insurer was promoting a sort of insurance policy or threshold insurance for petrol stations for tank leakage by having certain mechanisms to detect whether the tanks were leaking. Again, it is a risk management profile. I think I did not mention, but it is important to understand that credit risk assessment is a total situation. The environmental part of it is only one component. What a bank would look to, to ensure that through a company's normal cashflow it would have sufficient funds to meet any obligations that are likely to arise because of the specific nature of the site. Indeed in many cases the EPAs are now moving to financial assurances and bonds of that type or nature. So in this particular fact situation, it is a big ticket, very big problem, and you are talking lots of money and potential hazardous damage to human health. So the banks naturally would approach it from a very conservative viewpoint.

But in a service station situation, which is quite topical, I have had personal experience where customers have come to me and said "well you are asking all these questions on environmental issues, five years ago I got the loan from ANZ and no-one inquired at all". The general response is that you do not want to be lender of last resort in that situation. But you can work through their management systems. Have a look and satisfy yourself that they are a good environmental citizen. If their systems are in place, you can take a commercial risk with building some parameters around it. But I would have to stress that I think it has to be site specific.

Chris Schulz

We might move on to the "Environmental Loan Documentation Clauses" that you have got in front of you and just go through a few of those. So we are now really turning from the practical protection to the legal protection, and I suppose the representations and warranties are one thing again. From a practical point of view, unless you have done some sort of detailed site examination you are not going to be much help to the bank.

The thing that I wanted to focus on was maybe ask Chris Bishop, under covenant B(6), whether he would be free at 9 o'clock tomorrow when I deliver seven filing cabinets of all of the permits, and what the bank is going to do with them once they have got them.

Chris Bishop

I think the problem is a very real problem in that clause, and I am of the view that you will have to modify that under the Victorian position because that goes awfully close to getting into control of the process. And a bank will need to have sufficient information to be able to be armed to protect itself in the event of making a judgment to go into possession. But some of that material on a constant basis, ignorance is bliss in one sense.

This is where it comes back to the point that most general managers credit would be looking for an executive summary of the engineer's report to provide the necessary comfort to say that there are sufficient mitigants in the proposal to warrant it going forward, and pray like hell that the report is right and they did not miss the arsenic drum by one centimetre when they did a core sample. That sort of situation has to have a balanced approach to it. I agree with Chris. Some of these covenants seem to be over the top, but they will be standard for the middle market type of transaction. If you can negotiate them they should be, but nothing in my estimation will save the Governor-General. These covenants will not help if you get to the stage of going into possession and finding it is hopelessly contaminated.

Chris Schulz

One comment I had about a number of these covenants is that the issue of materiality just does not seem to come out. Clauses such as "not to pollute", heaven knows what that means. The other thing maybe Bryan can help me as Nifty's lawyer on, I am going to give this covenant B(11) that I am not going to bring on to the property any environmentally sensitive material. Could you give me some advice on that Bryan, what does that mean?

Bryan Jenkins

I think it would be almost impossible to give an accurate technical interpretation of what an environmentally sensitive material might be, because almost any material, in certain concentrations, can become an environmental contaminant. When you say "environmentally sensitive", I mean that is open to so many interpretations it would be a very difficult clause to actually put into operation. But again, you would have to look at the history of the site, see what is involved and what is proposed for the future, and reach an agreed schedule of materials. That could be done at a practical level, I would suggest.

Chris Schulz

On the subject of periodic audits for a contaminated site, having done some sort of a baseline study, I mean what is a periodic audit Bryan, and before you answer that, under C(1) and C(2), the two agreements that my poor client is being asked to let the bank have, environmental consultants combing this piece of land at the drop of a hat, what are the key dates, if you like, it would be reasonable to expect a bank to be able to come back and check on how things are going?

Bryan Jenkins

If you are looking at an ongoing operation, then the typical periodic environmental audit would be annual. If you are looking at a project which is about to be constructed, then you are really talking about at key stages in the project checking the areas that might be environmentally sensitive. For example, the excavation stage is usually the most critical in terms of the potential exposure for construction workers. And it is getting more towards the completion stage where you are concerned about the adequacy of the provisions that have been made for the end land use. But if there is encapsulation that is required, that it is actually intact and can be demonstrated to be intact.

One of the things that we often recommend, and this relates more to industrial but it can also be applied to commercial buildings, is to actually get commissioning tests done on those components which are environmentally sensitive. So if there is a pollution control device that has to operate at a certain level, that if your money is at risk in relation to the performance of that pollution control device, that you actually ask for a copy of the commissioning report. So there are a number of key things, depending upon the nature of the environmental risk that are probably more specific, that would be an advantage for the bank to seek. If you look at the issue that the borrower should agree and get the bank to engage environmental consultants at the cost of the borrower, I have not seen it in too many cases in terms of borrowings, but certainly when there are takeovers being considered, it is usually the takeover company which will engage consultants and then the company being taken over will also engage consultants. You can get a fight between consultants about what represents a risk in environmental terms. That is quite often used in a takeover sense. If there is remediation required or pollution upgrading required, that is used as a bargaining chip in terms of how much is paid for the company that is being taken over. So there are genuine financial consequences of the consultant's report on the need for clean-up, the need for remediation, or the need for additional pollution control.

Chris Bishop

Let us not forget that those clauses are there for a reason, for a bank to be able to manage its risk. I believe that with the Victorian model, the use of a statement of environmental audit in contradistinction to the current certificate of environmental audit will become commonplace for large projects, because it sends the benchmark as to what you are looking for and you can have it quantified to the degree of statutory acceptance that this is a site's state and its particular use.

Chris Schulz

I think that when you are looking at these clauses, there can be a tendency to just apply them in an automatic sense to various loans, no matter what the security. I think the point that Bryan makes, and I could not agree more, is that when you are sitting down to actually draft these with a particular loan in mind, you really need someone like Bryan to run past various clauses, because a whole host of the phrases that are used in there are the ones that if you ever want to enforce them, it is going to be engineers giving evidence as to partly what they mean. If you are not 100 per cent certain what effect that will have before you start preparing these covenants, they may well have totally unintended effects.

Question - Steven Brown (Parish Patience, Sydney)

Just two questions for the Panel on Clause B(11). Given that ignorance is bliss, would the bank want to know what environmentally sensitive materials will be on the property? Given the Victorian legislation, would it be best to take that out?

Response - Chris Bishop

I would tend to agree with that, although there is an obligation on a bank to be aware of the situation it would face if it went into possession. If the use changed, for example, and the practices on the site changed, it could be something that the banks would want to know about at an early stage.

Question - Steven Brown (Parish Patience, Sydney)

The second issue that I think was raised earlier, was the position of all other property being charged in the case of a contamination. How would that affect say a bona fide purchaser for value who has exchanged contracts, but has not yet settled, and in between the date of exchange there has now been a charge placed over the property?

Response - Chris Schulz

Just going back to your question about the environmentally sensitive materials. There are better ways that you could express clauses like that, but it would depend upon which legislation you are operating under. There are things like prescribed substances and you may want to know what prescribed substances are on the site because that then has action requirements if you are the person in control of that site. So the general concept of having environmentally sensitive materials on the site I think is a valid one, but the actual wording would need to tie in to what the statutory requirements or legal requirements are in a particular State, because they define certain types of substances which require you to take certain actions.

CONCLUDING COMMENTS

Chris Schulz

The issue then, just to touch briefly on the Victorian changes, is that my client has defaulted, Chris has now got the decision as to what to do about that, and he is conscious, as he mentioned before, of the exemption, that once he goes into day-to-day possession and active management and control of the premises that he will not be liable under the Act for any pre-existing pollution. The first issue there, before you go into active management, is how confident can I be that the baseline study is one that is going to identify fully the sources or the nature of the site, so that in twelve months time, when I come to sell the property and find that the contamination is much worse, how reliable are baseline studies?

Bryan Jenkins

If you go back to the comment I made earlier that if you want a guarantee that you have undertaken a site contamination assessment that covers all chemicals for the entire site, that means an analysis of the entire site which is clearly impractical. Chris mentioned the need for getting a copy of the executive summary of the consultant's report. The rider that I would add to that is that you should get the executive summary plus the consultant's disclaimer about how far the study has gone in terms of assessing contamination. Because the problem they have with certificates of audits in Victoria at the moment is that there is no-one who can guarantee that they have covered every aspect of potential contamination on the site. That is unrealistic. So what you need to look at is how that advice has been qualified. Now if you find that that advice is inappropriately qualified in twelve months time, then you have got someone whom you can sue, and there certainly have been a number of environmental consultants (not Kinhill) who have been sued for giving inappropriate advice that is found out to cost the client money later, to the tune of about $5 million in a recent settlement. So look at the disclaimer, and if you find that there is a problem later on, then you have got someone else you can sue rather than just the polluter.

Chris Bishop

I would not be as harsh on the engineers as that. It is move over accountants by the look of it. But as a good credit manager, I would have raised the specific provision when this loan was settled, and immediately write it off against that specific provision when we have to go into possession. Because on the facts of this case, it really does look like very little value add to get your money back if all the worst connotations of that anecdotal material comes home to roost. But the Victorian model at least gives you the opportunity to take legal possession and then negotiate with the EPA to work out an environmental improvement plan perhaps, or a way of mitigating the obligation to contain or avoid environmental hazards.

Chris Schulz

An important point in all of that really is that you need to be very cautions in using baseline studies, whether you are using those baseline studies at the commencement of the loan, during the course of it, and certainly upon default. I think there is a tendency, certainly in my experience in transactions I have been involved in, for people to attribute some sort of infallibility to these baseline studies — that if we have got this study done by someone reputable, then we can rely on it and we can draft everything around it. I think they just never have that degree of total certainty. As Bryan said, it is the best protection you can get at the time, but it is by no means the end of the discussion. You have still got a risk that twelve months down the track a pollutant is discovered that was not tested for in the baseline study, and you then have issues of how long has it been there, who put it there, and those issues certainly are very difficult ones to deal with.

Question - Professor Robert Baxt (Chairman)

I was going to ask one question in relation to the certificates that are prepared by these engineers. Assuming that you are dealing with the audit protection authority, to what extent does the production of a certificate, done by an organisation such as Kinhills, let you off the hook in terms of later potential prosecution?

Response - Chris Schulz

In the statements that deal with site contamination, it really depends on the thoroughness of that statement. These are done by auditors approved by the EPA, so they are not just done by any consulting firm. The certificates and the statements in Victoria can only be issued by the auditors that are approved by them. So I think those certificates would give you a great deal of comfort to rely on those in the future. But if something is missed and it was not negligent to have missed it (so you do not in a sense have any action), then I do not think necessarily that the fact that it was missed and that it was not negligent in any way restrains the EPA from then serving clean-up notices on you subsequently to remove that substance.

ENVIRONMENTAL LAW - ATTACHMENT 1

Slides used in presentation by Chris Schulz

OVERVIEW

- Accredited Licensees
- Lender Liability
- Statements and Certificates of Environmental Audit
- Combined Works Approvals and Environment Impact Assessment
- Others

ACCREDITED LICENSEES

- Any Licence Holder Can Apply
- High Level of Environmental Performance Required
- Environment Management System
- Environmental Audit Program
- Environment Improvement Plan
- Annual Performance Report
- Five Yearly Reviews

LENDER LIABILITY

- Definition of "Financial Institution"
- Changes to "Occupier" Definition
- Liability to Abate Environmental Hazards
- Exemption from Past Pollution

STATEMENTS OF ENVIRONMENTAL AUDITS

- Certificate of Environmental Audit
- Statement of Environmental Audit

COMBINED WORKS APPROVAL AND ENVIRONMENT IMPACT ASSESSMENT

- Application of Environment Effects Act 1978
- Joint Advertisement
- Simultaneous Submissions to Environment Effects Statement and Works Approval
- Panel Hearing, Not Appeal

OTHERS

- State Environment Protection Policies (SEPPs)
- Staged Licence Fee Payments
- Works Approval Timing
- Research, Development and Demonstration Approval
- Lead Levels in Petrol
- Intellectual Property Rights

ENVIRONMENTAL LAW - ATTACHMENT 2

Handout materials provided by Chris Bishop

Attachment 2A

Commentary

The case study brings into play as far as Big Bucks is concerned the part of credit risk assessment that has become greatly focused over the last few years, environmental considerations. Banks are certainly focusing more on these issues as the case study indicates.

However, I ask you to bear in mind that these issues form only one part of the credit risk assessment process of a bank.

Lending to environmental sensitive industries has become a difficult issue for banks since the risk of **direct liability** has been associated with lending to customers where environmental considerations arise as legislation in Australia has been seen to extend liability to banks directly for the environmental harm/damage caused by their customers.

As the case study points out, Big Bucks Bank is involved in consideration of financing the Casino project and as part of its assessment of the lending risk it clearly has considered the environmental liability risk associated with the project.

I would like to overview the position that would apply in Victoria as far as Big Bucks Bank is concerned following passing of the *Environment Protection (General Amendment) Bill* 1994.

Big Bucks Bank would now evaluate the project on the basis of the new laws in Victoria and as a result would be far more likely to do the deal following enactment of the Bill than they would have done before under the Victorian legislation or other legislation around Australia.

My assessment of the project is that the financing is likely to go ahead as Big Bucks Bank will fall within the lender liability exemption of the new Victorian provisions. The reasons for this view are illustrated by the words of the new laws which are set out on the overhead attachments.

Summary

In summary I feel that:

(a) Care will however need to be exercised to be sure that the site is not a risk site contaminating off-site as the bank would be liable if it went into possession for abatement of any hazard.

Consequently the bank would require, as mechanisms to reduce risk, an environmental assessment prior to approving the loan and probably a site assessment audit leading to a "statement of environmental audit" under section 57AA of the Victorian Act under the new provisions as a strong mechanism to restrict the risk.

(b) The bank will certainly seek the engineer's report as a condition of loan approval given the site history.

(c) The bank will be a passive lender in simply holding the security interest in the Casino site.

(d) The bank will be able to enter into possession as a mortgagee and only be liable to abate any environmental hazard and not be liable for past contamination.

Conclusion

The new Victorian provisions are a step in the right direction to avoid banks walking away from financing transactions for fear of direct liability for environmental risk and hopefully the principles of the exemptions will be followed in all other States.

Big Bucks Bank will approach this transaction with much more confidence as a result of the new laws and this is to be welcomed for Victoria.

Attachment 2B

Environment Protection (General Amendment) Bill

EXPLANATORY MEMORANDUM

The aims of this Bill are to more effectively integrate environmental and economic factors in government decision making, and to foster a more collaborative approach between industry, the community and government in achieving ecologically sustainable development.

The Bill will achieve these aims through a series of amendments to the **Environment Protection Act 1970**. The key elements of these amendments are reforms to project approval processes, improved development processes for statutory environmental policies, and clarification of lenders' environmental liabilities.

Notes on Clauses

Clause 1 sets out the purpose of the Bill.

Clause 2 identifies the date when the Bill will commence.

Clause 3 adds a definition of "financial institution" to the Act and clarifies the circumstances in which such institutions will be considered occupiers and therefore liable to the provisions of the Act. It also makes clear that where the costs of clean up cannot be recovered from an occupier, those costs can become a charge placed on the land of which the occupiers' premises formed a part.

Clause 4 establishes intellectual property rights for the Authority and gives it power to enter into commercial agreements related to such intellectual property.

Clause 5 repeals section 17(2) of the Act, which made contravention of a State environment protection policy or industrial waste management policy an offence.

Clause 6 adds new sections 18A-D to the Act and revises the existing section 19. These amendments establish a revised process for the preparation of State environment protection policies and industrial waste management policies. Under the revised process, the Authority must:

- advertise the intention to make or vary a policy and invite comment;
- prepare a draft policy;

- prepare a policy impact assessment outlining the key social, environmental and financial impacts of the proposed policy and principal alternatives;
- advertise a draft policy and draft impact assessment for public comment for a period of at least 3 months;
- consider and report to all submissions received;
- if required by the Minister, submit a recommended policy and impact assessment to a review panel for advice on the adequacy of the impact assessment;
- recommend the policy and impact assessment to the Governor in Council, together with any advice received from the review panel;
- table the policy before both Houses of Parliament and submit copies of the policy, policy impact assessment, summary of submissions received, the Authority's evaluation of the submissions and any advice received from the review panel to the Scrutiny of Acts and Regulations Committee;
- review a policy every 10 years and publish the result of the review in its Annual Report.

Policies that the Authority certifies are fundamentally declaratory, machinery or administrative in nature under section 18A, or industrial waste management policies that the Minister certifies need to be declared for special reasons without delay under section 18B, will not require a policy impact assessment or public comment. Such policies will be required to be submitted to the Governor in Council, the Scrutiny of Acts and Regulations Committee and both Houses of Parliament.

Clause 7 makes the review of policies a function of the Scrutiny of Acts and Regulations Committee through a consequential amendment to the **Parliamentary Committees Act 1968**.

Clause 8 amends section 19B(7) of the Act to require the Authority to refuse or issue a works approval within 4 months of the receipt of an application.

The clause also inserts a new section 19(3B) which provides that where a works approval application has been advertised jointly with an Environment Effects Statement (EES) required under the **Environment Effects Act 1978**, any submissions on the works approval application must be made together with any submissions on the EES.

Clause 9 introduces new sections 19D-G which establish an approvals process for research, development and demonstration (RD&D) projects. Firms wishing to undertake RD&D projects that would otherwise be subject to works approval can apply for RD&D approval with an application fee of 60 fee units. The Authority will determine whether the proposal constitutes RD&D and should be granted subject to whatever conditions it considers necessary within 30 days of the receipt of a complete application. The Authority will be able to amend, revoke or attach new conditions to an RD&D approval. Firms contravening RD&D approval conditions will be guilty of an offence under the Act.

Clause 10 adds a definition of "research, development and demonstration approval" into section 4 of the Act. It also gives such approvals prima facie evidentiary status through amendment of section 59A of the Act.

Clause 11 amends section 24(1) of the Act to allow the Authority to grant applications for payment of licence fees in instalments on the grounds of financial hardship, and to charge an additional interest fee to cover foregone revenue.

Clause 12 inserts new sections 26A-E into the Act to establish accredited licensees. Licensees will be able to apply to the Authority for accreditation as an accredited licensee for

a particular premises under section 26A. The Authority will be able to grant an application for accreditation if it is satisfied that the licensee has a high level of environmental performance and the capacity to maintain and improve environmental performance, as outlined under section 26B. The Authority will have to advertise its decision to grant accreditation in the Victoria Government Gazette.

Section 26C requires accredited licensees to submit annual performance reports to the Authority in a form agreed between the Authority and the accredited licensee. Provision of false, misleading or incomplete reports will be an offence.

Under section 26D, accredited licensees will have reduced licence fees and will not be required to obtain a works approval for works occurring within their licence conditions except for significant works as defined.

Section 26E allows the Authority to review the accreditation of an accredited licensee at any time if it is not satisfied that the accredited licensee is meeting requirements. The Authority must review the accreditation of an accredited licensee at least once every 5 years.

Clause 13 inserts definitions of "accredited licensee" and "environmental management system" into section 4 of the Act, prescribes a fee of 85 fee units for accreditation applications, and allows the Governor in Council to prescribe reduced fees for accredited licensees through regulations.

Clause 14 inserts a new section 33B(1B) which provides that a works approval which has been issued on an application, which has been jointly advertised with an EES and which is substantially in accordance with the EES assessment, will not be subject to third party appeal. (See clause 8).

Clause 15 restricts the lead content of petrol to a maximum of:

- 0.25 grams per litre for the period from the commencement of the **Environment Protection (General Amendment) Act 1994** to 31 December 1994; and

- 0.2 grams per litre, or whatever lower level is prescribed subsequently through regulations, from 1 January 1995 onwards.

The Governor in Council is empowered to make regulations under section 71(1) prescribing maximum and minimum amounts of petrol constituents, including further reduced levels for lead.

A consequential amendment is made to section 42A(5) to allow petrol purchasers to obtain a warranty from vendors certifying that petrol purchased meets these requirements.

Clause 16 allows environmental auditors who cannot issue a certificate of environmental audit that any beneficial use in an identified segment of the environment is protected to issue a "statement of environmental audit". Defined in section 4, statements of environmental audit can specify the particular beneficial uses which are protected in an identified segment of the environment.

Clause 17 corrects typographic and other minor errors in the Act.

Attachment 2C

Environment Protection (General Amendment) Bill No.

TABLE OF PROVISIONS

Clause

Attachment 2D

LEGISLATIVE ASSEMBLY

(As sent to the Legislative Council)

A BILL

for

An Act to amend the **Environment Protection Act 1970**, to consequentially amend the **Parliamentary Committees Act 1968** and for other purposes.

Environment Protection (General Amendment) Act 1994

The Parliament of Victoria enacts as follows:

1. ***Purpose***

The purpose of this Act is to amend the **Environment Protection Act 1970**—

(a) to provide for the assessment, review and scrutiny of State environment protection and industrial waste management policies;

(b) to establish an accredited licensee system;

(c) to facilitate the operation of the Act.

2. ***Commencement***

(1) Section 1 and this section come into operation on the day on which this Act receives the Royal Assent.

(2) Subject to sub-section (3), the remaining provisions of this Act come into operation on a day or days to be proclaimed.

(3) If a provision referred to in sub-section (2) has not been included in a proclamation made before 1 July 1994, it comes into operation on 1 July 1994.

3. ***When is a financial institution an occupier***

(1) In section 4 of the **Environment Protection Act 1970**—

(a) in sub-section (1) after the definition of "fee unit" **insert**—

"financial institution" means—

(a) a bank within the meaning of the Banking Act 1959 of the Commonwealth or a bank constituted by a law of a State or of the Commonwealth; or

(b) a financial institution within the meaning of section 3 of the AFIC (Victoria) Code; or

(c) a friendly society within the meaning of section 3(1) of the **Friendly Societies Act 1986**; or

(d) a financial corporation within the meaning of section 8 of the Financial Corporations Act 1974 which is registered under category D, E, F or G of that Act; or

(e) a financial institution, or a financial institution which is a member of a class of financial institutions, declared for the purposes of this definition by Order of the Governor in Council made on the recommendation of the Authority and published in the Government Gazette;'

(b) after sub-section (2) **insert**—

'(3) For the purposes of this Act, the definition of **"occupier"**—

(a) subject to paragraph (b), does not include a person being a financial institution and acting solely as a holder of a security interest in the premises, or as a mortgagee in possession, or which is, or appoints, a controller of the premises.

(b) does include a person being a financial institution when acting as a mortgagee in possession or which is, or appoints, a controller of the premises —

(i) for the purposes of the abatement of any environmental hazard in respect of the premises pursuant to a notice under section 31A, 31B or 62A; or

(ii) having possession and day to day active management and control of the premises (other than in respect of pollution that occurred prior to the financial institution becoming mortgagee in possession or becoming or appointing a controller).

(3A) In sub-section (3), **"controller"** means a receiver, or a receiver and manager, of the premises, or anyone else who is in possession or has control of the premises for the purpose of enforcing a security.'

(2) In section 62(3) of the **Environment Protection Act 1970** for "because the occupier cannot be found the costs become a charge on the property of the occupier" **substitute** "the costs become a charge on the property of the occupier or the land of which the premises forms a part as the case may be".

...

[Section headings appear in bold italics and are not part of the Act. (See **Interpretation of Legislation Act 1984**.)]

Attachment 2E

ENVIRONMENT PROTECTION (GENERAL AMENDMENT) ACT 1994

When is a Financial Institution an Occupier

(1) In section 4 of the **Environment Protection Act 1970** —

(a) in sub-section (1) after the definition of "fee unit" **insert** —

"financial institution" means —

(a) a bank within the meaning of the Banking Act 1959 of the Commonwealth or a bank constituted by a law of a State or of the Commonwealth; or

(b) a financial institution within the meaning of section 3 of the AFIC (Victoria) Code; or

(c) a friendly society within the meaning of section 3(1) of the **Friendly Societies Act 1986**; or

(d) a financial corporation within the meaning of section 8 of the **Financial Corporations Act 1974** of the Commonwealth which is registered under category D, E, F or G of that Act; or

(e) a financial institution, or a financial institution which is a member of a class of financial institutions, declared for the purposes of this definition by Order of the Governor in Council made on the recommendation of the Authority and published in the Government Gazette.'

(1) In section 4 of the **Environment Protection Act 1970** —

(b) after sub-section (2) **insert** —

'(3) For the purposes of this Act, the definition of **"occupier"** —

(a) subject to paragraph (b), does not include a person being a financial institution and acting solely as a holder of a security interest in the premises, or as a mortgagee in possession, or which is, or appoints, a controller of the premises.

(b) does include a person being a financial institution when acting as a mortgagee in possession or which is, or appoints, a controller of the premises —

(i) for the purposes of the abatement of any environmental hazard in respect of the premises pursuant to a notice under section 31A, 31B or 62A; or

(ii) having possession and day to day active management and control of the premises (other than in respect of pollution that occurred prior to the financial institution becoming mortgagee in possession or becoming or appointing a controller).

(3A) In sub-section (3), **"controller"** means a receiver, or a receiver and manager, of the premises, or anyone else who is in possession or has control of the premises for the purpose of enforcing a security.'

(2) In section 62(3) of the **Environment Protection Act 1970** after "property of the occupier" **insert** "or the land of which the premises forms part as the case may be".

...

Attachment 2F

ENVIRONMENTAL LOAN DOCUMENTATION CLAUSES

In order to provide maximum security protection against environmental non-compliance and contamination, loan documentation should deal with the following issues:

A. Representations and Warranties of the Borrower

The following representations and warranties should be required from the borrower —

(1) compliance with all environmental legislation;

(2) confirmation that all necessary permits, works approvals or trade waste agreements required have been obtained and have been complied with;

(3) past and present compliance with all laws;

(4) whether there is any outstanding litigation, restraining order or any potential civil claims or any claims by the EPA pursuant to any action taken under section 62 of the Act resulting from a clean up by the EPA;

(5) the condition of the property and the existence of any contaminant;

(6) the confirmation that the property is free from contamination and that no contaminants have been stored upon it;

(7) that the present use of the property may be lawfully continued and the proposed use of the property will be lawful;

(8) that the borrower has not been required to file any reports or statements with respect to environmental matters or if required, they have been filed and copies have been given to the lender;

(9) as to the details of any spills impacting upon the environment either on the property or from other properties which may affect the value of the security;

(10) the issue of any notices and compliance with them including any notice under section 62A of the Environment Protection Act;

(11) that the property is not on the Contaminated Sites Register and has not been nominated or listed for consideration for inclusion in the Register.

Any representations and warranties given should be without qualification as to the best of the borrower's knowledge or if that qualification is necessary stating that due and diligent enquiry has been made.

B. Covenants

The following covenants should be required:

The borrower should covenant —

(1) to maintain adequate insurance to the satisfaction of the Bank both for the assets and if necessary environmental impairment liability insurance cover;

(2) to comply with environmental laws and to comply with the conditions of any works approvals or licences;

(3) not to pollute;

(4) to obtain all necessary permits;

(5) to file all reports or statements required by regulatory bodies;

(6) to give the Bank copies of:

  (a) insurance policies;

  (b) permits;

  (c) notices received from any regulatory body;

  (d) claims and charges;

  (e) environmental management plans, where appropriate;

  (f) environmental assessments;

  (g) works approvals and licences and new applications for same (including applications for amendment);

  (h) any monitoring data or reports sought by the Bank;

(7) to inform the Bank of changes in legislation that impact on the assets the subject of the security;

(8) to inform the Bank of violations of statutes / regulations / permits / works approvals / licences / insurance policies;

(9) to inform the Bank of spills and to carry out any clean-ups required;

(10) to inform the Bank of significant changes in relation to disposition of wastes;

(11) not to create or bring upon the borrower's property any environmentally sensitive materials (except as agreed);

(12) to remedy promptly any spills or carry our any other remedial works to enable compliance;

(13) to permit the Bank to inspect, take samples and test (using consultants);

(14) to reimburse the Bank's expenses;

(15) to do periodic environmental audits;

(16) to maintain in good repair and to replace when necessary all equipment required to comply with environmental laws and all fencing, alarms and other security measures as are necessary to prevent vandalism which may cause an environmental spill;

(17) to institute appropriate training programs, and to engage for environmentally sensitive work only properly trained staff.

C. Agreements

(1) The borrower should agree to furnish the Bank periodically with such environmental audit and monitoring reports as the Bank requires.

(2) The borrower should agree to permit the Bank to engage environmental consultants at the cost of the borrower.

(3) The borrower should agree to indemnify and release the Bank in relation to environmental liabilities.

(4) The borrower should agree that in the event of receivership or sale, contaminated materials will be deemed to be personal property and may be separated from the land, placed in containers and stored on site or off site or otherwise treated at the expense of the borrower, and such materials will remain the property of the borrower.

(5) The borrower should agree to authorise the Bank to obtain information required by it from governmental authorities and to assist the Bank in that regard. Blank authorisations should be obtained in advance.

D. Default Provisions

The default provisions of the security documentation should be amended to include environmental contamination and non-compliance.

ENVIRONMENTAL LAW - ATTACHMENT 3

Slides used in presentation by Bryan Jenkins

SITE CONTAMINATION CONSIDERATIONS FOR LENDERS

LIABILITY OF LENDERS (Vic EPA)

- Passive Lenders
  - lend money, not involved in site management
  - not liable for pollution clean-up costs or offences
- Mortgagee in Possession
  - making the site safe (ie abating existing hazard)
  - ensuring future operation does not cause pollution
- Financial Institutions: Protection of Security
  - consider environmental liabilities in loan assessment
  - encourage environmental management by debtors
  - when in possession: ensure environment protected
- Financial Institutions: Environmental Responsibilities
  - manage hazards they inherit
  - full responsibility for businesses they manage
  - not liable for past pollution (except devaluation)

SITE CONTAMINATION MAJOR ISSUES

Urban Areas

- Issues
  - contaminated groundwater
  - land use
- Key problem areas
  - residential development on contaminated land
  - abandoned industrial land
  - waste disposal sites

Rural Areas

- Issues
  - contamination of agricultural produce
  - contaminated run-off
- Key problem areas
  - pesticide use
  - fertiliser use

TWO REGULATORY APPROACHES TO SITE CONTAMINATION

- Adherence to pre-determined soil criteria
  - used to define a condition of contamination
  - service as standard for clean-up
- Recognition of environmental consequences
  - soil criteria used as guidance to investigation requirements
  - site specific acceptance criteria
  - requires exposure and risk assessment

STEPS IN SITE CONTAMINATION AUDIT

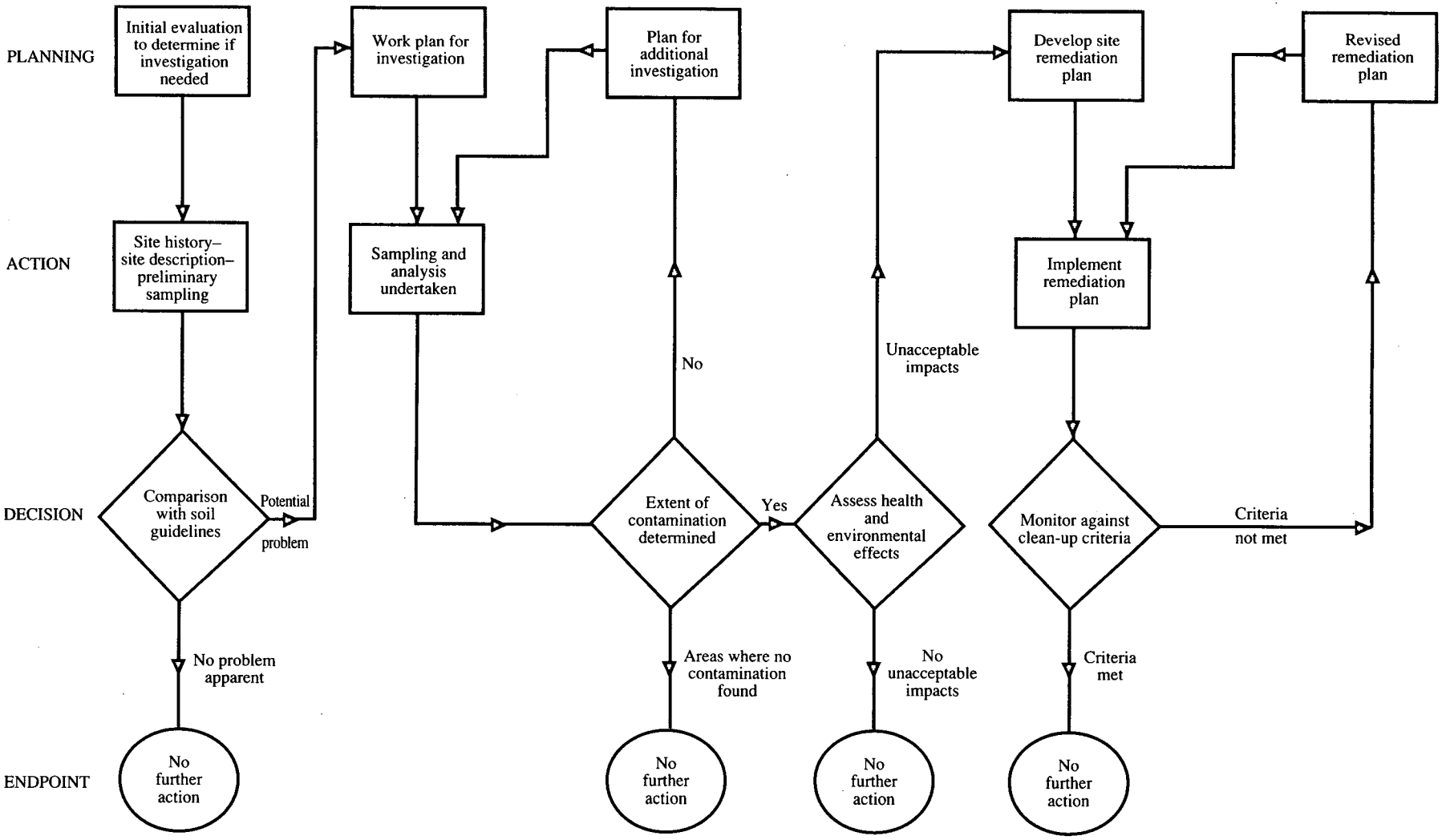
- Identification of possible contamination
- Systematic sampling and analysis programme
- Health and environmental risk assessment
- Remediation strategy

REMEDIATION STRATEGY

- Typical response in the past
  - removal then disposal in landfill
- Preferred approaches
  - treatment in situ
  - treatment of excavated soil
  - isolation by encapsulation or barriers
- Treatment/containment not possible
  - restrictions on future site use

PREVENTATIVE MEASURES

- Site selection
  - consider vulnerability of environment to containment
- Process design
  - consider alternative materials
  - incorporate pollution control equipment
- Equipment features
  - leak detection systems
  - enclosures and secondary containment
  - corrosion reduction, eg protective coatings
  - above ground storage
  - low leakage pumps and valves
- Housekeeping
  - immediate clean-up of spills
  - maintenance of drainage systems
  - separation of high-risk activities
  - material and waste audits
  - documentation to account for wastes
  - inspection of protection systems
  - staff training



DECISION STEPS IN SITE CONTAMINATION AUDITS